

If tangible personal property is transferred incident to a sale of service, this will result in either Service Occupation Tax liability or Use Tax liability for the serviceman. See 86 Ill. Adm. Code 140.101. (This is a GIL).

July 26, 1999

Dear Mr. Xxxxxx:

This letter is in response to your letter dated June 18, 1999 and your e-mail dated July 13, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

COMPANY provides targeted marketing services in the form of a PROGRAM whereby COMPANY acts as a 'general contractor' in providing grocery and drug stores with a program to build and maintain customer loyalty and repeat business by supplying a card and/or key tag which allows the holder beneficial discounts when patronizing a particular store. In connection with the purchase of the cards, the client has the option to engage COMPANY to provide 'PROGRAM services'. PROGRAM services are targeted marketing services designed to assist the retailer in retaining current customers, identifying potential customers, and increasing the volume of customer purchases.

COMPANY currently pays the Retailers Occupation Tax (ROT) in Illinois on the sales of the PROGRAMs sold to our clients located in Illinois. Below are the details of the transaction. Please let us know the position of the Illinois Department of Revenue on the portion of the invoice that should be assessed sales tax.

COMPANY sells 'PROGRAMs' to our clients located in Illinois. PROGRAMs are small plastic cards much like credit cards that grocery shoppers use to be identified as frequent shoppers or to obtain discounts and/or special sale prices. COMPANY is domiciled in STATE. The manufacturer of the cards, as well as the company that provides the card processing service, and the client in this particular case are all located in Illinois. COMPANY has nexus in Illinois for sales and use tax purposes.

COMPANY purchases the blank plastic cards from the manufacturer and resells the blank cards to our client. The client pays for and maintains an inventory of the cards at the location where the cards will be processed. Meanwhile the client's customers fill out

applications with information that will then be embossed on the card itself. The process by which the customer information is put on the card is called card processing. Card processing consists of thermal imaging the customers name onto the cards with black ink. At this time the barcode is also added. The card processor will then send the cards directly to the client's customers. COMPANY charges the client \$0.09506 for each blank card. The client pays COMPANY a processing fee of \$0.31872 to have their customer's names and barcodes added.

COMPANY believes that when the cards are sold to our client, Illinois Sales tax is due only on the cost of the materials. The card processing charges should not be subject to either the Retailers Occupation Tax or the Service Occupation Tax.

We respectfully request an opinion on this matter. Please contact the undersigned directly should you require additional information at #####.

Pursuant to our telephone conversation, we understand that the sales transactions described in your letter consist of two separate sales. The first is the sale of a specified amount of blank cards to your clients who maintain an inventory of those cards. The second sale concerns your company printing or embossing your customer's cards with specific information regarding your clients' customers.

Sales of blank plastic cards, such as those described in your letter, are generally subject to Retailers' Occupation Tax liability on 100% of the selling price of those cards. Blank plastic cards have intrinsic usefulness and so have commercial value to persons other than the customer. In contrast, sellers of personalized business calling cards, letterheads, envelopes, labels, name plates, badges, medallions and the like do not incur Retailers' Occupation Tax liability on their receipts from such sales because they are engaged in a service occupation in producing or procuring custom-ordered items that have no commercial value to others. Their sales, rather, are generally subject to the Service Occupation Tax. Please find enclosed a copy of 86 Ill. Adm. Code 130.1995 concerning Personalizing Tangible Personal Property.

The processing or printing of blank cards that are owned by the customer would generally be subject to Service Occupation Tax. Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. See the enclosed copy of 86 Ill. Adm. Code 140.101. Printing or embossing such cards generally involves the transfer of tangible personal property such as ink, laminate, plastic, or other materials that are attached or incorporated into the cards.

Businesses providing services (servicemen) may calculate their tax base in one of four ways: (1) separately stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act. Many printing or graphic art production businesses choose option number 3 or number 4 described below.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers.

Your letter indicates that another company is involved in providing the card processing service. This results in a relatively complicated multi-service situation for Service Occupation Tax purposes. Multi-service situations exist where a primary serviceman subcontracts work to a secondary serviceman. In multi-service situations, a primary serviceman's cost price is determined either by the separately stated selling price of the tangible personal property transferred from a secondary serviceman, or if the secondary serviceman does not separately state the cost of goods, it is presumed that the primary

serviceman's cost price is 50% of the secondary serviceman's total charge. See 86 Ill. Adm. Code 140.301 (a), enclosed.

When both primary servicemen and secondary servicemen are registered, primary servicemen may give a Certificate of Resale to registered secondary servicemen for any tangible personal property purchased. Primary servicemen could then collect Service Use Tax from their customers based upon the separately stated selling price of the property or 50% of the bill to the service customers.

If primary servicemen are registered and de minimis, they may choose to remit Service Occupation Tax to the Department based upon their cost price of tangible personal property purchased from secondary servicemen. If the cost price of the tangible personal property is not separately stated by the secondary serviceman, the cost price will be deemed to be 50% of the total bill from the secondary serviceman. Primary servicemen provide the secondary servicemen with Certificates of Resale if the secondary servicemen are registered, and collect Service Use Tax from customers on their cost price.

Please note that Public Act 89-675, effective August 14, 1996, states that if an unregistered de minimis serviceman subcontracts service work to an unregistered de minimis secondary serviceman, the primary serviceman does not incur a Use Tax liability if the secondary serviceman (i) has paid or will pay Use Tax on his or her cost price of any tangible personal property transferred to the primary serviceman and (ii) certifies that fact in writing to the primary serviceman. This certification option is only available in multi-service situations when both the primary and secondary servicemen are unregistered and de minimis, 35 ILCS 110/2 and 115/2.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.